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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 985

H. A. PHILLIPS, TRUSTEE OF THE SOUTHERN BREWING COMPANY, BANKRUPT,

Petitioner,

vs.

A. M. ARNOLD.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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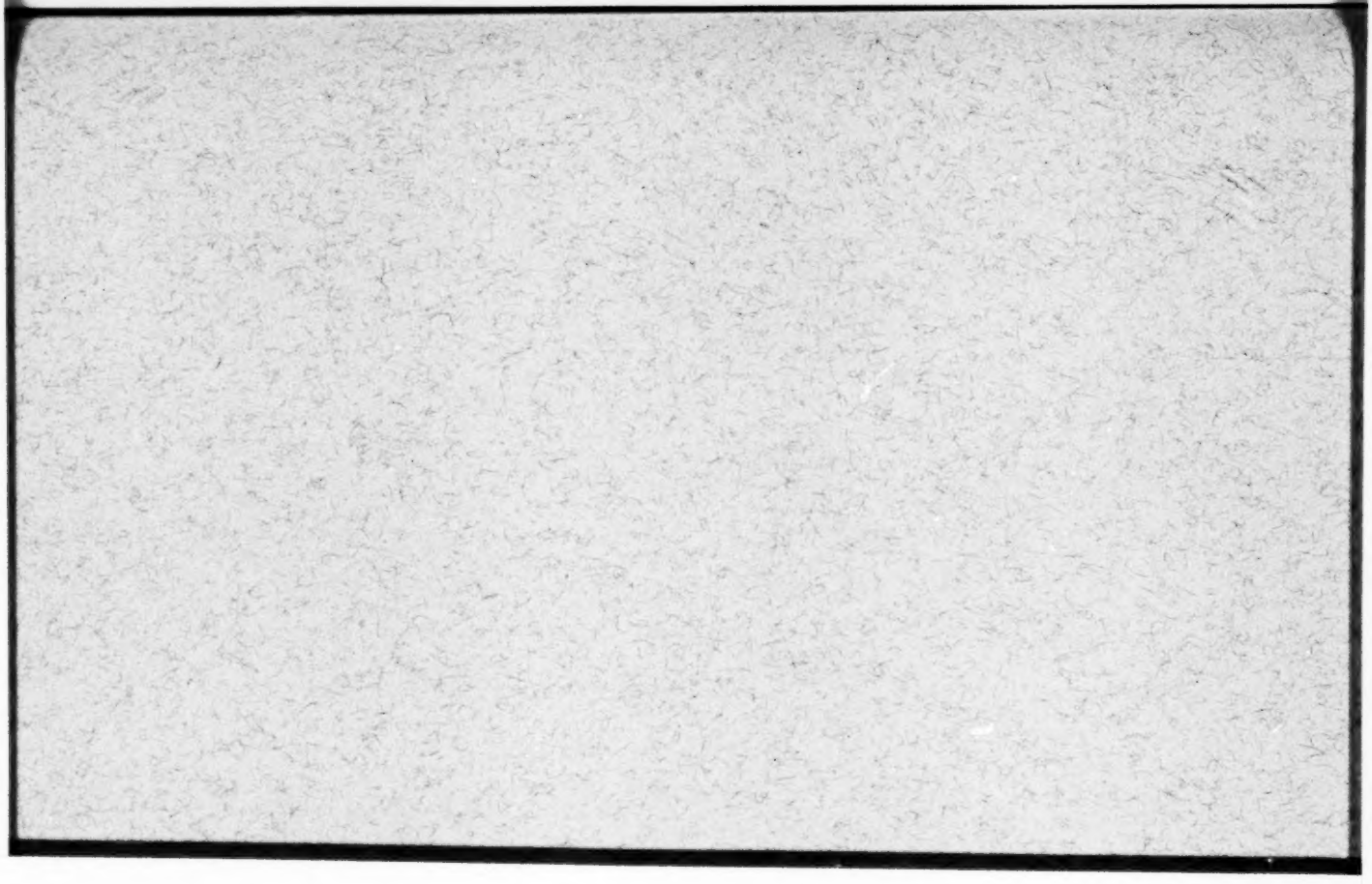

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vs.

A. M. ARNOLD.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

MAY IT PLEASE THE COURT:

H. A. Phillips, Trustee of the Southern Brewing Company, Bankrupt, respectfully prays that a writ of certiorari issue to review the final judgment rendered in this cause February 4, 1941, by the United States Circuit Court of Appeals for the Fifth Circuit in which the Circuit Court of Appeals reversed the judgment of the United States District Court for the Southern District of Texas.

I.

Summary Statement of the Matter Involved.

Respondent A. M. Arnold organized, and during most of its existence was the beneficial owner of all the stock of, the bankrupt, Southern Brewing Company, a Texas corporation. After its adjudication as a bankrupt its creditors discovered that substantially all the tangible property which had been used by it in the operation of its business of brewing and selling beer was being claimed by Arnold under a foreclosure, held about five months prior to the adjudication, of a deed of trust which he, as president of bankrupt, had, some years before, executed to secure himself, as its creditor.

Petitioner, as trustee of the estate, filed a petition before the Referee in Bankruptcy seeking to have declared null and void, the foreclosure, the deed of trust, and the claimed indebtedness, which as of the date of foreclosure amounted to $99,379 (R. 3-6). The principal basis for attack was that bankrupt was but an agency or instrumentality of Arnold; that it had not been treated by him as a separate entity; that the advances made by him to it should, therefore, not be considered as debts entitling him to participate in the assets, on a parity even, with other creditors, and that the deed of trust and trustee's deed, having been executed in an attempt to obtain priority, were illegal and void (R. 11-13).

Petitioner further charged that even if bankrupt should be considered a separate entity, so that Arnold could occupy the status of creditor, the deed of trust and trustee's deed were still invalid, the former for want of proper corporate action to authorize its execution and the latter because it was not recorded prior to bankruptcy (R. 13, 14).

After an extended hearing the Referee held Arnold's claimed indebtedness, as well as the deed of trust and trus-

tee's deed, "wholly void and of no force and effect" and that petitioner as trustee was "the owner of, and holder of the full legal title to" the property in question free and clear of any claim of Arnold (R. 277). The District Judge affirmed the order of the Referee (R. 82). The Circuit Court of Appeals held that the foreclosure was properly set aside and that $52,329 of the claimed indebtedness constituted capital contributions and not loans, but that the remaining $47,050 was a valid debt secured by the deed of trust.

II.

Opinions Below.

Findings of fact and conclusions of law were filed by the Referee on March 7, 1940 (R. 45). The District Judge filed a memorandum opinion June 24, 1940 (R. 78). The opinion of the Circuit Court of Appeals was filed February 4, 1941 (R. 280), and is reported at 117 F. (2d) 497.

III.

Jurisdictional Statement.

Jurisdiction of this cause is conferred upon this Honorable Court by Sec. 240 of the Judicial Code, as amended; United States Code, Title 28, Sec. 347, and by Sec. 24 (c) of the Bankruptcy Act of 1938; United States Code, Title 11, Sec. 47 (c).

IV.

Questions Presented.

1. Whether the sole, dominating stockholder of a corporation, who has organized and operated it as his adjunct or instrumentality, may also be its creditor.

2. Whether the sole stockholder of a corporation, which was operated merely as his corporate pocket, may so manipulate its affairs that when it becomes a bankrupt he

will have priority over its creditors in the satisfaction of his claims against it.

3. Where the sole stockholder of a corporation, who organized it with insufficient capital, intending to advance, under the guise of loans, the funds necessary for its operations, made advances to it shortly after incorporation, a part of which were subsequently withdrawn, after which he made additional advances, is there any sound distinction between the two sets of advances, so that while those made immediately after incorporation are construed as capital contributions, those made subsequently constitute valid loans?

4. Whether a deed of trust executed by the president of a corporation to secure an alleged indebtedness owed him by the corporation, without any authorization of its execution by the board of directors, all of whom had an interest in the transaction adverse to the corporation, constitutes a valid corporate act.

V.

Reasons Relied On for the Allowance of the Writ.

1. The Circuit Court of Appeals, in holding that the sole stockholder of a corporation, which he has used as a mere corporate pocket, may be a secured creditor of his corporate agency or instrumentality, has decided an important question of bankruptcy law in a way in conflict with applicable decisions of this Court. *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307; *Pepper* v. *Litton*, 308 U. S. 295.

2. The Circuit Court of Appeals, in holding that the sole stockholder and real owner of the business of a corporation, which has been organized and operated merely as his agency or instrumentality, may be a creditor of that corporation secured by a lien on all its assets, has rendered a decision

in conflict with the decisions of other Circuit Courts of Appeals on the same matter. *In re Kentucky Wagon Manufacturing Co.*, 6th Cir., 71 F. (2d) 802; *Centmont Corporation* v. *Marsch*, 1st Cir., 68 F. (2d) 460; *Henry* v. *Dolley*, 10th Cir., 99 F. (2d) 94; *Clere Clothing Co.* v. *Union Trust & Savings Bank*, 9th Cir., 224 Fed. 363; *New York Trust Co.* v. *Island Oil & Transport Corporation*, 2nd Cir., 56 F. (2d) 580.

3. In failing to hold that a deed of trust on corporate property, executed, without proper authorization of qualified directors, by the president of a Texas corporation, to secure advances made by him to his Company, is invalid, the Circuit Court of Appeals has decided an important question of local law in a way in conflict with applicable local decisions. *Tenison* v. *Patton*, 95 Tex. 284; *Texas Auto Company* v. *Arbetter* (Tex. Civ. App.), 1 S. W. (2d) 334; *Nicholstone City Co.* v. *Smalley* (Tex. Civ. App.), 51 S. W. 527.

VI.

SUPPORTING BRIEF.

Statement of the Case.[1]

The findings of fact made by the Referee were adopted by the District Judge and were not attacked by respondent. They establish that bankrupt was incorporated on July 12, 1933, with a nominal capital of $50,000, to serve as the agency or instrumentality through which respondent planned to engage in the brewing business (R. 50). He contributed the entire nominal capital and all the stock was issued to him except qualifying shares to his son-in-law, Otto, and an employee, Souza (R. 50, 51). At the time when the corporation was organized, respondent realized

[1] This statement is intended to be read with the summary statement of the petition, supra, pages 1-2.

the nominal capital was wholly insufficient and he planned to, and did, advance, for the construction and equipment of the brewery, additional sums totaling $70,500 (R. 51, 52). He made no attempt, at the time of these advances, to secure himself for them, but in September, 1934, without any authorization by the board of directors, he executed to his daughter, as trustee, a deed of trust covering all the real property of the bankrupt (R. 53). This deed of trust recited that it was to secure a note in the amount of $79,729 [2] and future advances. In 1937 and the early part of 1938 he made additional advances totaling $47,050 (R. 55, 56).

Detailed findings made by the Referee with reference to the manner in which the business of bankrupt was conducted show almost complete disregard of, broken only by occasional lip service to, the conventional methods of conducting a corporate business, and that bankrupt was used as nothing more than a corporate pocket of Arnold, who with disregard for the substance and form of corporate management treated its affairs as his own (R. 52-65). The effect of these findings is summarized in the Referee's certificate as follows:

> "In short, I think and find, that at the times when the advances in question were made the bankrupt was simply the agency or instrumentality of Arnold for carrying on the brewery business, and that the business of the bankrupt, though conducted through the form of a corporation, was in truth and in fact the personal business of A. M. Arnold." (R. 60.)

The evidence showed and the Referee found various abuses in the handling of the affairs of bankrupt of the sort which are, unfortunately, not infrequently associated with

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[2] The $79,729 was made up of the original $70,500, interest on that sum to June 30, 1934, amounting to $4,229, and an additional advance made in June, 1934, of $5,000 (R. 52).

one man ownership and domination of corporations. For example, during a period when the business seemed about to prosper, under the guise, in part, of interest and principal payments on the $70,500 advance, which had been necessitated by the inadequate capitalization, and, in part, of unauthorized salary payments, Arnold withdrew from its funds more than $90,000.[3] In addition to these direct withdrawals he organized another company known as Monte Carlo Distributing Corporation, with a paid-in capital of $1,000, all of whose stock was held by or for him, which handled about 80% of the output of the brewery, with the result that as of the date of bankruptcy it was indebted to bankrupt in an amount in excess of $85,000, which it had no assets to pay (R. 63-65).

As a result of these various manipulations, by the spring of 1938 the affairs of the Brewery were beginning to become seriously involved (R. 65). At this very time, peculiarly enough, respondent purported to transfer the business to his son-in-law, Otto. No consideration was paid for this transfer and the parties testified it was intended as a gift (R. 60). Even if *bona fide*, the transfer is unimportant, because all the advances involved were made before it (R. 55, 56). Significant, however, of the disregard by respondent, himself, of the corporate entity of bankrupt is the fact that after, as well as before, the purported transfer, though he no longer had any official connection with the corporation he continued to dominate and control its affairs (R. 60-61).

The condition of these affairs did not improve during the summer of 1938, and in the fall, respondent, being of the opinion that the failure of the enterprise was imminent,

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[3] He withdrew $19,000 at various times as "interest", $27,400 in the summer of 1936 as "principal payments" on the $79,729 note, and $45,000 as "salary"; none of these withdrawals being authorized by any corporate action (R. 55, 61, 62).

instructed his attorney to foreclose under the deed of trust (R. 65, 66). Pursuant to these instructions, a trustee's sale, at which Arnold was the only bidder, was held November 1, 1938, as a result of which his daughter executed to him a deed conveying the entire brewery premises, plant, and equipment, for a recited consideration of $99,379 (R. 66). This was the total amount in which, as a result of the various advances and withdrawals, he claimed bankrupt was indebted to him at that time (R. 66). This trustee's deed was not recorded until April 24, 1939, twelve days after the adjudication of bankruptcy, and during the intervening time bankrupt continued to occupy the property and operate the brewery business thereon exactly as it had before (R. 66-68).

Specifications of Error.

I.

The Circuit Court of Appeals erred in holding that Arnold, the real owner of the business of bankrupt, could at the same time be its creditor.

II.

The Circuit Court of Appeals erred in holding that Arnold, who organized and operated the bankrupt as his agency or instrumentality, could, by advancing money to it and taking a deed of trust upon its property as security, secure for himself the right, prior to its *bona fide* creditors, to subject its assets to the repayment of those advances.

III.

The Circuit Court of Appeals, after correctly holding the original advances made by Arnold to be capital contributions, erred in holding those subsequently made to be valid loans.

IV.

The Circuit Court of Appeals erred in ignoring the fact finding of the Referee and the District Judge that bankrupt was a mere agency and instrumentality of Arnold and in holding that it had a valid separate entity which could not be disregarded.

V.

The Circuit Court of Appeals erred in refusing to hold that if bankrupt could be regarded as a separate entity, the deed of trust was invalid for want of proper corporate action to authorize its execution.

BRIEF OF ARGUMENT.

Summary of the Argument.

A. Bankrupt was inadequately capitalized, operated as a mere corporate pocket of, and dominated and controlled by, A. M. Arnold throughout its existence, to such an extent that its affairs were managed, not for the best interests of the corporation, viewed as a separate entity, but to serve Arnold's individual interests. It was, therefore, properly held by the Referee and the District Judge that the business of bankrupt was in truth Arnold's business, that he could not be its creditor, and that all advances made by him for the purpose of carrying on that business should, as opposed to claims of *bona fide* creditors, be properly construed as contributions to its capital.

B. If bankrupt should be regarded as a separate entity from Arnold, the deed of trust was invalid for want of proper corporate action authorizing its execution.

Argument.

A.

The decision of the Referee and of the District Judge in this case is based upon the familiar principle that in order to prevent wrong courts of equity will look through the form of corporate entity to the substance beneath. Application of this principle, in circumstances similar to those here involved, by at least five of the Circuit Courts of Appeals and numerous Federal District Courts, has resulted in every case in a holding that the sole stockholder of a corporation, organized and operated as a mere adjunct or instrumentality for carrying on all or a portion of the stockholder's personal business, is in truth the real owner of that business, and can not, therefore, also be its creditor.[4]

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[4] Some typical decisions are *In re Kentucky Wagon Mfg. Co.*, 6th Cir., 71 F. (2d) 802; *New York Trust Co.* v. *Island Oil & Transport Corp.*, 2nd Cir., 56 F. (2d) 580; *Clere Clothing Co.* v. *Union Trust & Savings Bank*, 9th Cir., 224 Fed. 363; *Centmont Corp.* v. *Marsch*, 1st Cir., 68 F. (2d) 460; *Forbush Co.* v. *Bartley*, 10th Cir., 78 F. (2d) 805; *Henry* v. *Dolley*, 10th Cir., 99 F. (2d) 94; *In re Charles K. Horton, Inc.* (D. C. Tex.), 22 Fed. Supp. 905; *In re Otsego Waxed Paper Co.* (D. C. Mich.), 14 Fed. Supp. 15; *In re Burntside Lodge, Inc.* (D. C. Minn.), 7 Fed. Supp. 785.

In *In re Kentucky Wagon Mfg. Co., supra*, the Bank of Kentucky, which had occupied exactly the same status toward Kentucky Wagon Manufacturing Company that Arnold did to the bankrupt here, was denied the right to prove its claim upon a mortgage executed to secure advances made by it to the Manufacturing Company. The Sixth Circuit Court of Appeals there said:

> "The determinative question is, not whether the New Company was in fact a legal entity or corporation, but whether the relationship of agent and principal existed as between it and the Bank; *i. e.*, whether the New Company was an instrumentality of, or an adjunct to, the Bank. * * * To allow the claim would be nothing short of permitting the Bank to prove its debts against itself and satisfy them out of its own assets to the exclusion of the rights of bona fide creditors. It is also apparent that the $2,000,000 mortgage was in

A similar application of the principal has been made by this Court in the recent cases of *Taylor* v. *Standard Gas & Electric Company,* 306 U. S. 307, and *Pepper* v. *Litton,* 308 U. S. 295. The latter of these contains an extensive review of the authorities, and cites with approval nearly every one of the decisions mentioned in the margin above. Petitioner submits that the reasoning and language of the *Pepper* case squarely support the ruling of the District Court here and are decisive of this case.

The record here shows a combination of nearly every one of the circumstances enumerated by this Honorable Court in the *Pepper* case as requiring the subordination of so-called loans or advances by a sole stockholder to the claims of other creditors. The evidence established, and the Referee found, "dominancy and exploitation" of the bankrupt by Arnold; that bankrupt was used "merely as a corporate pocket" of Arnold, "who, with disregard of the substance or form of corporate management, has treated its affairs

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substance nothing more than an attempt to secure to the Bank a lien upon its own property."

In the *Kentucky Wagon Manufacturing Company* case the court completely ignores the corporate fiction. In others of those cited above, the same result is reached by superimposing on that fiction another; that the advances made by the stockholder are not loans but contributions to the capital of the business. Such a case is *New York Trust Co.* v. *Island Oil & Transport Corp., supra,* where Circuit Court of Appeals for the Second Circuit said:

> "If a subsidiary is a mere instrumentality and its business is really that of the parent company, a loan by the parent to the subsidiary will be subordinated to the claims of creditors of the subsidiary. *Baker Motor Vehicle Co.* v. *Hunter,* 238 F. 894 (C. C. A. 2); *S. G. V. Co.* v. *S. G. V. Co.,* 64 P. 265; 170 A. 271. The reason is that the proprietor of a business cannot lend money to the enterprise and thus curtail the rights of creditors by sharing in *pari passu* with them, and such loan is regarded as a contribution to the capital of the business."

Whatever the method of approach, however, the decisions with substantial unanimity have arrived at the same result; that is, the postponement of the claim of the sole stockholder to that of bona fide creditors.

as his own''; that bankrupt was incorporated with a nominal capital wholly insufficient to enable it to operate and that ''the capital necessary for the scope and magnitude'' of its operations was furnished by Arnold under the guise of a loan.

The record further shows beyond question an attempt on the part of Arnold, which the decision of the Circuit Court of Appeals would, in part, crown with success, to, ''by the use of the corporate device avail himself of privileges normally permitted outsiders in a race of creditors''; to utilize ''his strategic position for his own preferment''; to do ''indirectly through the corporation what he could not do directly'', and, as the dominant influence over the bankrupt, to use ''his power not to deal fairly with the creditors of that company but to manipulate its affairs in such a manner'' that when its creditors came to collect their just debts ''the bulk of the assets had disappeared'' into Arnold. Indeed, on these facts, a harsher remedy than that applied by the District Court might have been invoked and Arnold might well have been held personally liable for the debts of bankrupt.[5]

The Circuit Court of Appeals, while agreeing with the Referee and District Judge that the advances made by Arnold shortly after incorporation should be treated as capital contributions and that they did not, therefore, constitute valid debts, based its decision solely on the inadequate capitalization. Even if the Circuit Court's view that this was the sole ground for striking down the claimed indebtedness were correct, its holding that advances necessitated by original inadequate capitalization should not be

[5] Cf. *Consolidated Rock Products Co.* v. *DuBois*, — U. S. —. In that case the plan of reorganization actually provided for the cancellation of such of the bonds of the subsidiaries as were held by the parent and, therefore, gave the creditors all the relief they are asking here, but this Court held it should have gone further and subjected the assets of the parent to the claims of the creditors of the subsidiaries.

treated as debts, but that those necessitated, in large part at least, by depletion of the capital through unauthorized withdrawals should be, is clearly unsound. Its effect is to permit the doing, by indirection, of what it holds cannot be done directly. If the Court very properly frowns on the launching of a corporation with inadequate capital it is impossible to comprehend why it should sanction the depletion, after launching, of the capital to a point where it is again inadequate.

An even more fundamental fault with the opinion of the Circuit Court, however, is that it wholly ignores the vital fact, found by the Referee and District Judge, and not disputed by respondent, that bankrupt was merely respondent's agency or instrumentality. It is not entirely clear from the opinion whether the Court took the view that this finding was not supported by the evidence or whether it was regarded as immaterial. Since the former would constitute an effort to overthrow concurrent fact findings by the Referee and District Judge when no attack had been made on them and would thus constitute a clear usurpation of the fact jurisdiction of the trial court, it must be assumed the Court of Appeals took the latter view and regarded the finding as immaterial. This interpretation of the opinion is strengthened by the fact that the court recognizes that its holding is not in harmony with the language used and decisions cited in *Pepper* v. *Litton,* and construes that opinion as not approving those decisions, saying:

> "While an extensive review of authorities was made in the Pepper case, with a classification of them as to the remedies applied, there was no specific approval of any, but only a decision of the case before the Court" (R. 288).

This one sentence from the opinion makes clear the fundamental point of difference between the District Court and

the Circuit Court of Appeals. The former has construed the opinion of this Court in the *Pepper* case as meaning what it says and has applied the principles there laid down to the facts in this case, which they unquestionably fit. The latter has attempted to limit the scope of this Court's opinion to the particular facts there involved, in disregard of the language, which is susceptible of no such limitation. It is submitted that the District Court was clearly right and the Court of Appeals clearly wrong.

While the Circuit Court has held, and petitioner agrees, that the validity of the claimed indebtedness is a question of bankruptcy law and, therefore, not one as to which the law of Texas will govern, it may not be inappropriate, since respondent has contended to the contrary, to point out that it is settled law in Texas that where one person owns and controls all the stock in a corporation, whenever, in the interest of justice it is necessary to do so, the courts will unhesitatingly look through the corporate shell to the substance of the sole stockholder behind,[6] and that the only Texas decision discussing the precise question here presented; that is, whether a sole dominating stockholder can

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[6] *Aransas Pass Harbor Co.* v. *Manning,* 94 Tex. 558; *Boston & Texas Corp.* v. *Guarantee Life Insurance Co.* (Tex. Civ. App., Err. den.), 233 S. W. 1022; *Williams* v. *Freeport Sulphur Co.* (Tex. Civ. App.), 40 S. W. (2d) 817; *Continental Supply Co.* v. *Forrest E. Gilmore Co.* (Tex. Civ. App.), 55 S. W. (2d) 622; *Lybrand* v. *Miller-Lybrand Co.,* (Tex. Civ. App.), 75 S. W. (2d) 286; *Bush* v. *Gaffney* (Tex. Civ. App.), 84 S. W. (2d) 759; *Irish* v. *Bahner* (Tex. Civ. App.), 109 S. W. (2d) 1023.

In *Aransas Pass Harbor Co.* v. *Manning,* the leading Texas decision, the Supreme Court says:

> "Other decisions tend to the conclusion that whilst in theory of law, the corporation and its stockholders are distinct persons, and the latter have no agency for the former, yet equity, which looks to the substance of things, may, in an appropriate case, and for the purposes of justice, treat a debtor corporation, and an individual owner of all its shares as identical."

be also a creditor of the controlled corporation, answers that question in the negative.[7]

Thus whether the matter be considered as governed by the Federal or the Texas decisions, the judgment of the District Court was right and that of the Circuit Court of Appeals wrong.

B.

Even if the Circuit Court of Appeals was correct in its conclusion that the advances made by Arnold to the bankrupt in 1937 and 1938 constituted valid loans, it does not follow, as that Court further held, that the deed of trust created a valid lien. Petitioner attacked the deed of trust on the alternative ground that even if bankrupt should be held to be a separate entity from Arnold and not simply his agency or instrumentality, the deed of trust was, nevertheless, void, or voidable, because not properly authorized by any qualified representatives of bankrupt (R. 13).

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[7] *United States & Mexican Trust Co.* v. *Delaware Construction Co.* (Tex. Civ. App.), 112 S. W. 447. (The South Western Reporter erroneously shows "Writ of Error granted" in this case. We are advised by the Clerk of the Supreme Court of Texas that no writ was ever applied for.) There, in a suit brought to foreclose a mortgage on the properties of Texas Southern Railroad Company, Delaware Construction Company, the sole stockholder of the Railroad Company, was denied the right to participate in the proceeds of foreclosure as holder of some of the bonds secured by the mortgage. The Court said:

> "But there is still another reason which we think is sufficient to deny a recovery of the intervenor in this case. While the shareholders are, in a sense, separate and distinct from the corporation, in many transactions equity will regard them, for practical purposes, as being the same. *Aransas Pass Harbor Co.* v. *Manning*, 94 Tex. 563. The construction company, as the owner of the railway company, did indirectly whatever was done by the latter. * * * To permit the construction company through its domination to burden the property of the railway company with incumbrances, a part of which it may hold, and then share to that extent with the bona fide purchasers of bonds, would be to give that company the right to incumber its own property with liens in its own favor."

The Referee and District Judge, since they struck down the indebtedness as a whole, did not find it necessary to pass on this alternative contention (R. 76). They did, however, find the facts material to it. These were that the trust deed was executed by Arnold without any meeting or resolution of the board of directors of the bankrupt to authorize it and that at the time of its execution, if the bankrupt should be considered an entity separate from Arnold, all three of its nominal directors were interested adversely to it in the transaction (R. 53). These facts, which fully support petitioner's contention, were wholly ignored by the Circuit Court of Appeals, as was, indeed, this entire branch of the case.

It is fundamental that a corporation may sell or mortgage its principal properties only by action of its board of directors. In Texas,[8] moreover, it is well settled that a board of directors may act for the corporation only in a regularly constituted meeting.[9]

Furthermore, it is the law of Texas that contracts between a corporation and one of its directors or officers wherein

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[8] It is clear that the law of Texas governs questions relating to the formal validity of corporate acts.

[9] *Austin City Railway Co.* v. *Swisher* (Tex. Ct. App.), 1 White & Willson Civil Cases, 33; *Nicholstone City Co.* v. *Smalley* (Tex. Civ. App.), 51 S. W. 527; *Wichita Falls Electric Co.* v. *Huey* (Tex. Civ. App.), 246 S. W. 692; *City of Floydada* v. *Gilliam* (Tex. Civ. App.), 111 S. W. (2d) 761.

In the Nicholstone case the court, in striking down a contract for erection of improvements which attempted to give a lien on the corporate property, said:

> "But superior to any such consideration is the proposition that neither the individual directors, nor a majority, however great, of stockholders, acting separately, could thus bind the corporation. Action, in itself binding on the corporation, could only be taken by them as a body at a regularly constituted meeting, for the reason that it is only thus that all interests are represented and heard."

the adversely interested director purports to act for the corporation are invalid.[10]

Since the deed of trust was executed by Arnold, as president of the bankrupt, to his daughter, as trustee for himself; since it was not authorized by any resolution of the board of directors of the bankrupt; and since, indeed, all the directors, if bankrupt be considered a separate entity from Arnold, were interested adversely, clearly the deed of trust did not constitute a valid corporate act.

It follows then that if the Court of Appeals was right in treating the bankrupt as a separate entity, it was necessarily wrong in upholding the deed of trust, which can be sustained as a corporate act only by disregarding the corporate entity and treating Arnold's acts as those of the bankrupt.[11] Such a view would, of course, make necessary the affirmance of the judgment of the District Court that Arnold could not be a creditor at all. To ignore this dilemma, as did the Circuit Court, may be an easy, but it could hardly be said to be a just, solution.

Conclusion.

It is respectfully submitted that this case calls for the exercise by this Court of its supervisory power. The deci-

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[10] *Tenison* v. *Patton*, 95 Tex. 284; *Texas Auto Company* v. *Arbetter* (Tex. Civ. App.), 1 S. W. (2d) 334. As said in the Arbetter case:

> "It is a wholesome and thoroughly settled rule that a director of a private corporation cannot vote, with propriety, in a matter affecting his private interest, any more than a judge can sit in his own case. He cannot, with propriety, deal in his own behalf in respect of the corporate property, or in respect of any matters involving the exercise of his duties as director. And, when he violates this rule of propriety, and enters into a contract with the corporation, especially a contract of purchase of corporate assets, and his vote as a member of the board is necessary to the passage of the resolution authorizing it, this action of the board is sometimes void, and in all cases voidable, at the instance of the corporation, or of its stockholders, or of its injured creditors."

[11] *Aransas Pass Harbor Co.* v. *Manning*, 94 Tex. 563.

sion of the Circuit Court of Appeals for the Fifth Circuit unsettles important questions decided by this Court in *Pepper v. Litton* and makes it essential to the orderly and uniform administration of estates in bankruptcy that certiorari be granted and that, upon submission, the judgment of the Circuit Court of Appeals be reversed and that of the District Court affirmed.

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